

# Climate risk and the global energy transition

Investment Stewardship

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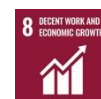
**BlackRock's approach to climate risk and opportunities and the global energy transition is based on our fundamental role as a fiduciary to our clients.**

**As the world works toward a transition to a low-carbon economy, we are interested in hearing from companies our clients are invested in about their strategies and plans for responding to the challenges and capturing the opportunities this transition creates.**

**As we are long-term investors on behalf of our clients, how well companies navigate and adapt through the transition will have a direct impact on our clients' investment outcomes and financial well-being.\***

At BlackRock, the money we manage is not our own. It belongs to our clients – people saving over the long-term to meet their financial goals, like a secure retirement, a child's education, or buying a first home. Climate risk and the energy transition have a similarly long-term time horizon, and while companies in different sectors and geographies will be affected differently, this transition is an increasingly unavoidable investment issue. Therefore, as stewards of our clients' assets, we engage companies to understand how they identify and manage both the risks and opportunities of climate change and the energy transition.

BlackRock Investment Stewardship (BIS) plays a key role in advocating for the long-term interests of our clients and their investment outcomes. In order to assess companies' strategies to navigate the energy transition, BIS meets with companies and, where we have authority to do so, votes proxies in the economic interests of our clients.<sup>1</sup> Our engagements extend well beyond the proxy season to periodically assess companies' strategic and operational responses to climate risk and opportunities and the energy transition. In our feedback to companies, we seek to offer a long-term perspective focused on durable profitability.



## UN SDGs alignment

We believe that there is significant intersection between many of the topics that we discuss with companies and aspects of these five [Sustainable Development Goals](#) (SDGs).

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\* In this paper, we make frequent reference to terminology pertaining to the transition to a low carbon economy. The Intergovernmental Panel on Climate Change provides a helpful [glossary](#) for this terminology.

As explained in our [Global Principles](#), climate change has become a critical factor in companies' long-term profitability.

**We look to company leadership to disclose to investors how climate risks and opportunities might impact their business, and how these factors are addressed in the context of a company's business model and sector. Specifically, investors have greater clarity – and ability to assess risk – when companies detail how their business model aligns to scenarios for the global economy that limit temperature rise to well below 2°C, moving toward net zero emissions by 2050.**

We recognize that the energy transition will not happen overnight, and that it is already uneven. However, companies that seek to mitigate risks and capture opportunities will be in a stronger position to drive long-term value. A growing number of companies, institutions, as well as governments, have already stated their net zero ambitions, and there is growing consensus that an orderly, just transition<sup>2</sup> to net zero will benefit companies and the economy, which will benefit our clients.<sup>3</sup> Many companies are determining what their role should be in navigating the energy transition and the transformation of how the world produces and uses energy, moves goods and people, and constructs the built environment. They are also controlling for different public policy paths as countries aim to align greenhouse gas (GHG) emissions with their national commitments.

**In this context, we seek to understand companies' plans for how they intend to deliver long-term financial performance through the energy transition, consistent with their business model, sector and geography.** We look for companies to demonstrate they have strategies in place that address and are resilient to a range of scenarios, including likely decarbonization pathways well below 2°C, as well as global ambitions to limit temperature rise to 1.5°C.<sup>4</sup> We also encourage companies to disclose how considerations related to having a reliable energy supply and just transition affect their plans.

**We are better able to assess the long-term performance of our clients' investments, when companies define short-, medium-, and long-term science-based emissions targets,\* where available for their sector, and disclose how these targets will affect the long-term economic interests of shareholders.** In some sectors, companies may have an opportunity to highlight strategies to develop alternative energy sources and technologies that can create value while contributing to an orderly transition. We recognize that it will take time to retool the capital-intensive industries that provide critical services to the global economy, and we maintain that carbon-intensive companies have a crucial role to play in an orderly transition. Continued investment is also required to maintain a reliable, affordable supply of fossil fuels during the transition. As long-term investors, it is easier for us to assess risk and opportunity for our clients when companies disclose how capital allocation across alternatives, transition technologies, and fossil fuel production is consistent with their business strategy and their emissions reduction targets.

At BlackRock, we expect to remain long-term investors in carbon-intensive sectors because these companies play crucial roles in the economy and in an orderly energy transition. We have some clients who avoid such investments and others who take an alternative approach. Recognizing the range of client preferences, we realize the careful balance between risk and opportunity is particularly important for traditional energy companies – as well as those companies that largely rely on carbon-intensive fuels for their operations, such as heavy industrials and utilities.

The section **Climate-related voting**, below, provides more detail on our approach to engagement and voting, on matters related to climate risks, opportunities, and navigating the transition to a low-carbon economy. As outlined in BIS' [market-specific voting guidelines](#) (and in more detail below), where corporate disclosures are not adequately aligned with the pillars of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) – governance, strategy, and risk management – or a company has not provided scope 1 and 2 emissions disclosures and meaningful short-, medium-, and long-term targets, we are unlikely to support director(s) considered responsible for climate risk oversight. We may also support, on a case-by-case basis, shareholder or management proposals that we conclude strengthen a company's approach to climate risk and the energy transition.

At this stage, we view scope 3 emissions differently from scope 1 and 2, given methodological complexity, regulatory uncertainty, concerns about double-counting, and lack of direct control by companies. **While we encourage companies to disclose their scope 3 emissions and targets where material to their business model, we do not consider such scope 3 disclosures and commitments essential to our support for directors.**

This is not to minimize value chain, or scope 3, emissions. They are a major global societal issue and, for companies where they are material, the prospect of future policy change could affect the economic viability of their business models. To effect change in scope 3 emissions in a fair and balanced way, policy action by governments will be necessary. Companies cannot solve scope 3 on their own. As national and regional policy expectations around scope 3 evolve and crystallize, we will look to companies to align their disclosures and commitments accordingly.

\* BIS generally considers short-, medium-, and long-term targets to be a range of years, such as 0-5, 5-10, and 10+ years. Our goal is not to set finite timelines, but to understand how companies consider emissions reduction efforts over the years as they transition toward net zero. Consistent with guidance from [TCFD](#), specifying exact timeframes across sectors could hinder organizations' consideration of climate-related risks and opportunities specific to their businesses. We encourage companies to decide how to define their own timeframes according to the life of their assets, the profile of the climate-related risks they face, and the sectors and geographies in which they operate.

## Climate risk and opportunity as an investment issue

The financial impacts of climate risk and transition risk will reverberate across all industries and global markets, affecting long-term shareholder returns, as well as economic stability.<sup>5</sup> This shift has significant implications for the profitability and pricing of virtually all assets in the investment universe.<sup>6</sup> BlackRock research calculates that inaction regarding climate risk could lead to a global cumulative loss in economic output of nearly 25% over the next two decades. Research has also found that while the transition to a net zero economy can introduce inflationary pressures,<sup>7</sup> an orderly transition is ultimately more likely to boost growth and mitigate inflation as compared to scenarios in which no efforts are undertaken to manage climate risk or there is an eventual rush to decarbonize.<sup>8</sup>

As such, we endeavor to consider climate and transition-related risks and opportunities in our clients' portfolios, and to assess asset values in the context of different transition scenarios. As a steward of our clients' assets, we take a long-term perspective with regard to the future financial performance of companies whose products and strategies could be most affected by the transition, as well as how companies across all sectors and geographies are aligning their plans with the possibility of a lower carbon future. We recognize that there are significant financial risks inherent in the transition, including potential for stranded assets.<sup>9</sup>

**Equally, we are interested in hearing from companies on their decarbonization investment opportunities.** For some, this may mean meeting a growing consumer demand for low-carbon versions of products and services. For others, it may mean investing in and developing current and future low-carbon technologies. Such emerging technologies are critical to the rate at which emissions can be reduced and may well provide fresh opportunities for companies to expand on business lines, grow resources, and provide clean energy aligned with net zero goals.<sup>10</sup> Companies that can effectively realize such opportunities are likely to better navigate the energy transition, and BlackRock's capital markets assumptions<sup>11</sup> estimate that this will impact expected asset class returns and shift strategic asset allocation towards companies that are better equipped to navigate these dynamics.<sup>12</sup>

We are also interested in companies' perspectives on and plans to invest in hydrocarbons, such as natural gas. We recognize that continued investment is required to maintain a reliable, affordable supply of fossil fuels during the transition.

As noted above, an orderly transition is ultimately more likely to boost growth and mitigate inflation as compared to scenarios in which no efforts are undertaken to manage climate risk or there is an eventual rush to decarbonize. Accordingly, and as long-term investors, we seek to understand how public companies are considering the impact to their valuations and long-term business models as they assess various options for hydrocarbon-producing assets including divesting the assets versus winding them down. We have seen companies face reputational risk as they look to sell such assets to private, less transparent buyers, given that, while this might help move the companies to net zero, it might not reduce emissions from the asset.

In addition, our assessment is<sup>13</sup> that companies that position themselves to navigate a strategic, timely, and just transition toward net zero, including considerations of broader stakeholder impacts, are those more likely to avoid operational disruptions, secure the support of their key stakeholders, and provide shareholders with durable investment returns.

## Companies' preparedness to navigate the energy transition

Investors — our clients — must depend on company boards and executives to set and execute strategies that deliver long-term, durable financial performance. As one of many, and typically a minority shareholder, BlackRock is not in the position to dictate a company's strategy or its implementation. Our role, on behalf of our clients as long-term shareholders, is to better understand how company leadership is managing risks and capitalizing on opportunities to protect and advance the economic interests of shareholders.

As stated in our Global Principles, we look to companies to disclose their business plan for how they intend to deliver long-term financial performance through the energy transition, in the context of their business model, sector, and geography. Clear disclosures allow investors to assess how companies are adapting their business models to respond to different transition scenarios.

As investors, we understand that net zero pathways will not be linear or streamlined; energy markets and the macro-economic environment are complex and volatile, and there is a great deal of regulatory and geopolitical uncertainty.<sup>14</sup> In this context, we therefore rely on the board and management, who are best positioned to determine what approach will equip the company to navigate climate risks and pursue emerging opportunities. Thorough company disclosures allow investors to track progress — whether positive or negative — and to understand what strategic changes may be undertaken to manage key risks, such as emissions reduction efforts.

Consistent, comparable data across companies in the market allows investors to better analyze companies and allocate capital. That is why we endorse disclosures aligned with the [Taskforce on Climate-related Financial Disclosures \(TCFD\) framework](#), as well as industry-specific metrics, such as those identified by the Sustainability Accounting Standards Board (SASB). The four pillars of the TCFD — governance, strategy, risk management, and metrics and targets — allow companies to use a common vocabulary and disclose to investors standardized information, in both data and narrative form. While this is a voluntary, admittedly complex, and evolving reporting recommendation, we believe that companies that consider all aspects of the TCFD framework and provide suitable detail will be in a better position to maintain investor confidence and support.

Consistent with the TCFD, **we look to companies to demonstrate how their business model aligns to scenarios that limit temperature rise to well below 2°C, moving toward net zero emissions by 2050.**<sup>15</sup> **We, and other investors, are better able to assess progress and identify innovative leaders, when companies disclose scope 1 and 2 emissions, along with short-, medium-, and long-term**<sup>16</sup> **science-based reduction targets, where available for their sector.**

As investors, it is important to be able to evaluate companies' assessments of their emissions across their value chain, or scope 3 emissions, and reduction targets, particularly where such emissions are material to their business. These disclosures provide important insight into the full carbon component of companies' goods and services. This further allows us to evaluate the long-term risks and resilience of companies across their value chain.

That said, we fully recognize that the methodology, accounting, assurance, and regulatory landscape for scope 3 emissions is complex, varied, and very much still evolving — and double counting is a legitimate concern. Accordingly, we understand that the disclosures companies are able to make in this area will necessarily be on a good faith and best-efforts basis.

Where companies adopt [carbon offsets and/or nature-based solutions](#) to advance carbon neutrality goals, we find disclosures detailing how these projects or offsets are evaluated and assessed for their permanence and additionality, as well as for leakage, to be beneficial.<sup>17</sup> This provides investors assurance that such investments achieve their stated purpose. We see carbon offsets as a complement to, not a replacement for, companies' substantive and sustained long-term emissions reductions plans.

## Climate-related voting

**Voting on our clients' behalf, when authorized to do so, is one of our core Stewardship responsibilities. Without exception, our decisions are guided by our role as a fiduciary to act in our clients' long-term economic interests. We aim to be a supportive, long-term focused shareholder who takes the context in which a company operates into consideration and makes voting decisions to advance our clients' interests. Climate-related voting decisions carefully assess companies' risk oversight and mitigation, alongside their disclosures detailing how climate risk and opportunity are integrated into their strategy and plans.**

As outlined in BIS' [market-specific voting guidelines](#), when corporate disclosures do not sufficiently enable investors to assess risk through the TCFD framework — including in relation to governance, strategy, and risk management — or companies have not provided scope 1 and 2 emissions disclosures and meaningful short-, medium-, and long-term targets, we are increasingly unlikely to support director(s) we consider responsible for climate risk oversight.

For companies operating in sectors where value chain, or scope 3, emissions are a material portion of their carbon footprint, we may also consider scope 3 disclosures, commitments, and reduction goals in our assessment of a company's overall transition preparedness and efforts to decarbonize. However, these factors are necessarily taken alongside other company actions and strategic decisions, including scope 1 and 2 emissions reduction efforts.

At this stage, we view scope 3 emissions differently from scope 1 and 2, given methodological complexity, regulatory uncertainty, concerns about double-counting, and lack of direct control by companies. **While we encourage companies to disclose their scope 3 emissions and targets where material to their business model, we do not consider such scope 3 disclosures and commitments essential to our support for directors.**

We may support, on a case-by-case basis, shareholder or management proposals that we conclude strengthen a company's approach to climate risk and the energy transition — these proposals may encompass scope 1, 2, and/or 3 disclosure requests. We view support for shareholder proposals as the appropriate approach where we see a lack of responsiveness to investor concern or progress in a company's disclosures and/or approach to climate risk. In some instances, we may also support shareholder proposals where a company is moving in the right direction, but where we believe our support would signal a need to accelerate progress on an issue or emphasize the importance of the underlying shareholder concern.

Our analysis of shareholder proposals may also include consideration of how a company has historically responded to proposal support and other governance concerns voiced by shareholders. As stated in our [Global Principles](#), and applied via our [regional voting guidelines](#), we take a cautious approach to shareholder proposals and generally do not support those that we believe would result in over-reaching into the basic business decisions of the company.

## Climate-related voting considerations in emerging markets

We recognize that some countries in emerging markets may not have reached peak emissions, as outlined by their Nationally Defined Contributions (NDCs). In these countries, the dialogue with companies around GHG emissions, climate risk, and the energy transition may be more nascent. We are mindful of this context in our discussions with the companies in these countries.

Nonetheless, we have also seen governments in emerging markets progressively raising their medium- and long-term emissions reduction targets. Regardless of the current rigor of a particular NDC target, we consistently seek to understand from companies how multilateral efforts, like the Paris Agreement<sup>18</sup> and the Conference of the Parties (COP), may prompt their government to increase their policy ambition, and in turn, increase the transition risk for these companies, in particular stranded assets. While we recognize varying contexts for companies in emerging markets, investors' interests will benefit as companies take meaningful action to manage their carbon emissions and address transition risks — particularly in anticipation of future regulatory commitments to reach peak emissions and move towards net zero.

## How we engage with companies on the energy transition

**BIS regularly and methodically engages company executives, and, as appropriate, board directors. We have had multi-year engagements with many of the companies in which we invest on behalf of our clients, building a strong foundation for constructive dialogue on governance, climate risk, and other sustainability matters that can have an impact on long-term financial performance.**

Engagement enables us to assess a company's approach to material drivers of business risk and opportunity, which in turn helps inform our voting. In our engagements, we also provide feedback from the perspective of a supportive, long-term shareholder on behalf of our clients. That said, we consistently maintain that executive leadership and the board, informed by feedback from investors and other stakeholders, are best positioned to determine the course of action that, in their view, is in the best economic interests of their company and investors.

Where companies seem unresponsive to investor concerns, expressed through engagement and/or voting, this may be reflected in reduced shareholder support for directors or, where investors have discretion, a decision to exit or reduce holdings.

We understand that the energy transition presents different challenges and potential rates of change for companies across sectors. Our focus is therefore on engaging with companies regarding how they are managing the transition — and how they are factoring it into their long-term business plans and emissions reduction targets. As laid out in 2021, we are focusing our efforts where the transition is likely to most materially impact a company's performance. To that end, the [BIS Climate Universe](#), which includes over 1,000 carbon-intensive public companies, represents nearly 90%<sup>19</sup> of the global scope 1 and 2 GHG emissions of the companies in which BlackRock invests on behalf of our clients.

In the following, we outline engagement considerations regarded as relevant for all companies, in addition to a few that are specific to carbon-intensive industries.

## Considerations for all companies

As companies determine the best approach for addressing their climate-related risks and opportunities, it is helpful for long-term investors like BlackRock to understand how:

- The board and management assess climate risk and possess knowledge appropriate to the company's business to ensure adequate consideration of climate-related risks and opportunities in relation to the company's strategy and operations
- The board and management consider the impacts of climate risk and the energy transition on the company's long-term performance, including opportunities to consider energy supply, innovation, and diversification of energy sources
- The company considers shifting demand for goods and services due to changes in regulation, technology, and/or consumer preferences that may result from the global energy transition
- The company measures its current emissions baseline, sets short-, medium-, and long-term science-based emissions reduction targets, where available, and evaluates resilience to scenarios, including most likely decarbonization pathways, well below 2°C, as well as the aspirational 1.5°C pathway
- The company executes year-on-year, or over a series of years, against its stated emissions reduction goals and other climate-risk related efforts
- The company incorporates climate risk in its capital allocation decisions, including investments in sustainable solutions, opportunities, business lines, renewable energy, and/or low-carbon products – and how such investments are support the long-term economic interests of shareholders
- The company considers and, if relevant, quantifies, and accounts for material climate-related risks in its financial statements, including if the company explains such risks within the context of its audit report and/or as part of the company's strategic planning and performance outlook<sup>20</sup>

## Additional considerations for traditional energy, utilities, and carbon-intensive companies

At BlackRock, we expect to remain long-term investors in carbon-intensive sectors because these companies play crucial roles in the economy and an orderly energy transition. We have some clients who avoid such investments and others who take an alternative approach. Recognizing the range of preferences, we realize the careful balance between risk and opportunity is particularly important for traditional energy companies – those making investments in oil and gas, as well as those companies that largely rely on carbon-intensive fuels for their operations, including heavy industrials and utilities. In addition to the points stated above, we believe it is helpful for investors to understand:

- How companies are balancing short-term investment with a long-term outlook toward the energy transition, particularly where investments and capital allocation primarily increase dependence on hydrocarbons
- The positioning of a company's operating model under a low-carbon future scenario, including the role a company expects to play in contributing to the reliable, affordable supply of energy

We recognize that companies cannot deliver the energy transition in isolation. A range of stakeholders, including policy makers and consumers, have a role to play to ensure a better equilibrium between supply and demand, given the global economy's current dependence on traditional energy sources and the parallel need to invest in cleaner energy alternatives and other technologies. In our engagements we may also discuss how companies see their role in achieving that equilibrium.

## Conclusion

As a fiduciary to our clients, many of whom will be invested for decades, BlackRock necessarily takes a long-term perspective in our engagement and voting. Consistent with helping clients achieve positive investment outcomes, we aim to be supportive of and provide constructive feedback to companies, particularly when they are managing business challenges. Our focus is consistently on understanding how companies' governance and business models enable long-term value creation and durable financial returns.

Underpinning our view that investors and companies ultimately benefit from greater disclosure of emissions reduction targets and transition plans is our conviction that *climate risk is investment risk*. Companies that anticipate and adapt to manage climate risk and capitalize on emerging opportunities in the transition to a low carbon economy are more likely to attract investor support.

Through engagement, we endeavor to understand the management and reporting of climate-related risks and ascertain how companies plan to harness opportunities emerging through the transition to a low-carbon economy. We believe that these efforts are a crucial component of our fiduciary duty to our clients to act in their economic interests and to deliver to our clients durable, long-term financial returns.

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## Appendix

In our engagements with companies, we have encountered a set of 'frequently asked questions' – topics where companies are keen to understand a long-term investor's perspective as they develop their climate risk and energy transition plans. The following sections provide additional insight into topics related to climate risk and their energy transition from the view of shareholders focused on positive, durable investment outcomes.

### TCFD and material, industry-specific sustainability metrics

***Many of the companies we invest in on behalf of our clients have commented on the burden and difficulty created by lack of a single standard for sustainability-related disclosures, and conflicting requests to adopt competing frameworks.***

Consistent, comparable data enables better analysis and decision-making. As with other metrics, effective disclosure of climate-related risks and emissions data allows investors to understand a company's position and make more informed asset allocation decisions. It also enables markets to price the financial impact of climate risk more accurately, which in turn can reallocate capital to companies poised to navigate or capitalize on the transition to a low-carbon economy. Both companies and their investors benefit when succinct and material factors relevant to the company's business are disclosed in a manner that supports understanding of climate-related risks and opportunities.

To that end, we advocate for disclosures aligned with the reporting framework developed by the Task Force on Climate-related Financial Disclosures (TCFD), supported by industry-specific metrics, such as those identified by the Sustainability Accounting Standards Board (SASB). The TCFD, of which BlackRock is a founding member, was established to develop consistent climate-related financial risk disclosures for use by companies, banks, and investors to provide information on risk exposure to shareholders. SASB standards provide companies and investors better visibility into the physical, liability, and transition risks associated with climate change. They guide companies to provide financially material and decision-useful information that is comparable within each industry.

The four pillars of the TCFD – governance, strategy, risk management, and metrics and targets – give companies a standard framework to disclose information, in both data and narrative form. While this is a voluntary standard, we find companies increasingly considering all aspects of the framework and providing an appropriate level of detail in their disclosures for their business model.

BlackRock recognizes the importance of meeting the same standards of disclosure we ask of the companies our clients are invested in. We maintain that effective disclosure can improve how companies manage risk and capitalize on opportunities to benefit of all stakeholders. In December of 2021, BlackRock published our second standalone TCFD-aligned report with [disclosures in line with the TCFD framework](#).

Given the crucial importance of consistent standards companies can adopt, we are supportive of a global baseline set of sustainability reporting standards, such as that underway with the International Financial Reporting Standards (IFRS) Foundation and the creation of the International Sustainability Standards Board (ISSB).<sup>21</sup> As efforts to align different standards progress, we will continue to support TCFD-aligned reporting, including industry-specific metrics, so investors and companies have the information they need to assess risk management plans, actions, and intended outcomes. While climate-related reporting is expected to gradually converge, we recognize that this process takes time and appreciate that companies may also be subject to regional or market reporting requirements. We have invested in resourcing our stewardship function to ensure we have a strong command of local market context, nuance, and requirements.

Furthermore, we anticipate that climate risk will become an increasingly important financial reporting and audit consideration, particularly at companies with carbon-intensive business models or that otherwise have a material exposure to climate risk. Guidance from each of the three leading organizations working on reporting standards (International Accounting Standards Board (IASB), the Financial Accounting Standards Board (FASB) and the International Audit and Assurance Standards Board (IAASB)) has been clear that under existing standards, companies should prepare to take material impacts of climate risk, including the impact of the energy transition, into consideration when preparing financial statements.<sup>22,23</sup>

## **BIS Climate Universe**

***There is growing recognition that climate risk and the energy transition are already transforming both the real economy and global finance. Regardless of business model, sector, size, or geography, companies are engaging with investors as they determine how demand for their goods and services may change, and how efforts to reduce emissions will affect durable financial performance.***

That said, in 2020, we focused our climate-related engagement on 440 public companies that represented about 60% of the global scope 1 and scope 2 GHG emissions of the companies in which BlackRock invests on behalf of clients. Of those companies, we identified 244 as, at that time, not adequately assessing and addressing their exposure to and management of climate risk. As laid out in our engagement principles and priorities, we voiced concerns from a long-term investor perspective and, when authorized to do so, voted on behalf of our clients. We were encouraged that, by 2021, many had made meaningful efforts to address investor feedback.

In 2021, we expanded our focus universe to over 1,000 carbon-intensive public companies that represent nearly 90% of the global scope 1 and 2 GHG emissions of the companies in which BlackRock invests on behalf of our clients.<sup>24</sup> The list is developed from publicly available information and is intended to focus engagement efforts where the energy transition is likely to have the most material impact on a company. Like many governance issues, the energy transition is long-term in nature and will continue over the coming years. Fortunately, the BIS climate universe includes many companies that are leaders in their sectors — they have defined climate risk strategies, rigorous GHG reduction targets, and are creating the technology and solutions that are vital for capitalizing on the transition. Others are at a much earlier stage in that journey. For more information, please see the full list of companies included in our [Climate Universe](#).

## **Assessing resilience for multiple energy transition scenarios**

***In conducting climate scenario analysis as part of their TCFD disclosures, companies often seek perspectives from long-term investors as they weigh up the climate change scenarios that are most relevant to their business, sector, or geography.***

In our [Global Principles](#), we state that we look to companies to disclose a business plan for how they intend to deliver long-term financial performance through the transition to global net zero, consistent with their business model, sector, and geography. We encourage companies to develop plans that are resilient under likely decarbonization pathways well below 2°C, as well as the growing global aspiration to limit warming to 1.5°C.<sup>25</sup>

- **Possible decarbonization pathways, well below 2°C.** In the Paris Agreement, countries around the world agreed to keep global warming “well below 2°C above pre-industrial levels [while] pursuing efforts to limit the temperature increase to 1.5°C.” Current projections suggest that if governments fulfil their commitments made at the 2021 Conference of Parties, “COP26,” Climate Change Conference, in full and on time, global warming could be limited to 1.8°C.<sup>26</sup>
- **Global aspirations to limit warming to 1.5°C.** A recent report by the Intergovernmental Panel on Climate Change (IPCC) argues that steep GHG reduction efforts are needed. The report states that “unless there are immediate, rapid, and large-scale reductions in greenhouse gas emissions, limiting warming to close to 1.5°C or even 2°C will be beyond reach”<sup>27</sup> and the worst effects of climate change will largely be unavoidable. Meeting these goals would require the implementation of public policies that actively support economies in shifting away from reliance on fossil fuels.



We understand that there are multiple pathways to achieving net zero. As a fiduciary to our clients, we seek to understand how companies are navigating this uncertainty. We have found that public disclosures of companies' scenario analysis, transition plans, and emissions reduction efforts<sup>28</sup> better enable the market to quantify climate-related risk, and in turn better inform investor capital allocation decisions.

Ideally, companies' scenario analysis will demonstrate how their business plans can accommodate a range of transition pathways. A shift in energy mix, and resilience under a 1.5°C pathway, may already be viable in the very short-term for some sectors where renewable energy, such as wind, solar, nuclear, and hydro, are readily available and cost competitive.<sup>29</sup> However, this may be more difficult for other sectors — particularly for carbon-intensive companies or those that rely heavily on hydrocarbons.

These outcomes can greatly impact the value of the assets we invest on behalf of our clients. For carbon-intensive energy producers, we recognize the need to continue to provide reliable, affordable energy, alongside investment in alternative sources and technology. This dual-track approach requires a careful balance of investment in alternative energy for the future, while shifting carbon-intensive energy sources to the cleanest and lowest emitting options available today.

In our discussions with companies, we focus on the alignment between a company's long-term strategy to navigate the transition and management's near-term investments in the energy sources and technologies upon which that strategy depends.\* We are also interested in the company's views on both scientific viability and commercial feasibility — as well as how planned investments are consistent with the long-term economic interests of shareholders.

## **Carbon offsets and nature-based solutions**

***The companies we invest in on behalf of clients may employ carbon offsets in the short- and medium-term as they innovate or develop the technology that will support further reductions in their overall GHG emissions.***

We see companies' carbon offsets as a complement to, not a replacement of, substantive and sustained long-term emissions reductions plans working towards a low-carbon economy. We welcome recent work to develop a standardized, transparent, and verifiable approach to purchasing and using carbon credits.<sup>30</sup> This standardization offers an additional benefit of allowing investors who wish to do so to direct private financing toward projects and innovations required to lower the cost of emerging climate technologies.

As such, we believe voluntary carbon credits and markets should be used as a supplement to science-based emissions reduction efforts on the path to net zero. Voluntary carbon markets and instruments should not replace or disincentivize efforts to rigorously reduce emissions.

We support companies' decisions to invest in technologies and solutions beyond their operational emissions reduction goals. When doing so, companies and their investors will benefit from adequate disclosures of how these projects or carbon credits are evaluated and assessed for their permanence and additionality, as well as for leakage and double counting. This helps assure investors and other stakeholders that such investments are achieving their stated purpose.

## **Effect of transition on all stakeholders**

***The directors and management of many of the companies we invest in on behalf of our clients often seek to engage with us on their role in mitigating the effect of the energy transition on key stakeholders including employees, suppliers, customers, and the communities in which they operate.***

Public policy and regulation, while constantly evolving, will play a critical role in an orderly transition. Nevertheless, companies that consider the impact of the energy transition on their key stakeholders — employees, customers, and the communities in which they operate — will likely be best positioned over the long-term. In particular, this may include the need to consider employee training and re-training, resources, and relocation — in order to deliver long-term, durable value for shareholders. This may also help mitigate severe disruption and dislocation — which in turn, may reduce the possibility operational downtime and associated costs.

For example, in the oil and gas industry, we are interested in understanding the scale and pace at which companies are allocating capital to both mature and emerging or underused technologies, such as nuclear, scalable carbon capture and storage technology, direct air capture, biofuels, and deployment of green hydrogen as an alternative fuel source, among other nascent technologies.

We encourage companies to understand, and disclose plans to address, potentially significant adverse impacts and/or unintended consequences that may arise through the energy transition. We recognize that private sector cannot do this alone – action will need to be accompanied by comprehensive public policy initiatives. Governments have an important role to play in ensuring access to reliable and affordable energy sources, in supporting communities affected by the transition, and in research, development, and demonstration of innovative technologies.

When we engage with companies on their approach to contributing to a smooth and equitable transition, we typically focus on understanding:

- The company’s strategy for addressing the needs of employees, suppliers, communities, and customers in the context of an energy transition and the metrics and targets used to measure results
- The processes in place to aid constructive dialogue and representation of affected employees, suppliers, communities, and customers in the company’s overall climate strategy
- In sectors where workers may be displaced as a result of the transition, programs in place for affected workers, including re-training and re-deployment opportunities, as well as the company’s contribution to ‘green’ jobs
- The balance between maintaining affordable access to products and services, including the role the company plays in preserving a reliable, affordable supply of energy, while facilitating a shift to a low-carbon economy
- The company’s environmental and social due diligence standards across the supply chain
- The company’s community engagement to address related transition risks, including partnering to support local economic development, and obtaining (and maintaining) the free, prior, and informed consent of Indigenous peoples for business decisions that impact their rights

## Endnotes

1. For more information on BIS engagement and voting, please see the 2020 Calendar Year Annual Report: <https://www.blackrock.com/corporate/literature/publication/blk-annual-stewardship-report-2020-calendar-year.pdf>
2. The Paris Agreement notes that efforts to transition to a low carbon economy need to take “...into account the imperatives of a just transition of the workforce and the creation of decent work and quality jobs in accordance with nationally defined development priorities”. See: <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>
3. For example, BlackRock’s Capital Markets Assumptions anticipate 25 points of cumulative economic gains over a 20-year period in an orderly transition as compared to the alternative. This better macro environment will support better economic growth, financial stability, job growth, productivity, as well as ecosystem stability and health outcomes.
4. The global aspiration is reflective of aggregated efforts; companies in developed and emerging markets are not equally equipped to transition their business and reduce emissions at the same rate – those in developed markets with the largest market capitalization are better positioned to adapt their business models at an accelerated pace. Government policy and regional targets may be reflective of these realities
5. See report by McKinsey Global Institute, “Climate Risk and Response: Physical Hazards and Socioeconomic Impacts, Jan 2020, <https://www.mckinsey.com/business-functions/sustainability/our-insights/climate-risk-and-response-physical-hazards-and-socioeconomic-impacts#>
6. See BlackRock publication, Sustainability: The tectonic shift transforming investing: <https://www.blackrock.com/corporate/insights/blackrock-investment-institute/publications/sustainability-in-portfolio-construction>
7. <https://www.blackrock.com/corporate/literature/whitepaper/bii-macro-perspectives-january-2022.pdf>
8. <https://www.blackrock.com/institutions/en-zz/insights/portfolio-design/turning-climate-risk-into-opportunity>
9. <https://www.blackrock.com/corporate/literature/whitepaper/bii-portfolio-perspectives-february-2021.pdf>
10. Stranded assets are those that at some time prior to their anticipated useful life are no longer able to earn an economic return as a result of changes associated with the transition to a low-carbon economy; these assets are worth less than expected as result of changes associated with the energy transition. Stranded assets can include construction costs that may not be recouped; capital that has to be retired before being amortized; loss of premiums or loss of insurance coverage; unanticipated or premature write-downs; and oil and gas resources that are owned but are no longer profitable to extract
11. See Stopping Global Warming Will Cost \$50 Trillion: Morgan Stanley Report: <https://www.forbes.com/sites/sergeiklebnikov/2019/10/24/stopping-global-warming-will-cost-50-trillion-morgan-stanley-report/?sh=91a745c51e23>
12. See BlackRock Investment Institute climate-aware capital markets assumptions (CMAs) as of February 2021, <https://www.blackrock.com/institutions/en-zz/insights/portfolio-design/turning-climate-risk-into-opportunity>
13. <https://www.blackrock.com/us/individual/insights/blackrock-investment-institute/investing-in-climate-awareness>
14. <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>
15. See Stopping Global Warming Will Cost \$50 Trillion: Morgan Stanley Report: <https://www.forbes.com/sites/sergeiklebnikov/2019/10/24/stopping-global-warming-will-cost-50-trillion-morgan-stanley-report/?sh=91a745c51e23>

16. <https://www.blackrock.com/us/individual/insights/blackrock-investment-institute/investing-in-climate-awareness>
17. <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>
18. See BlackRock, February 2022, Managing the Net-Zero Transition: <https://www.blackrock.com/corporate/literature/whitepaper/bii-managing-the-net-zero-transition-february-2022.pdf>
19. Throughout this publication, our reference to “net zero” refers to “net zero GHG” emission rather than “net zero carbon dioxide” emissions. We are aware that the goal for a net zero GHG economy is technically more ambitious than the current pathways outlined for a 1.5-degree scenario. However, our ambitious focus highlights the urgency of action in order to maintain the opportunity to achieve this goal. In scenarios limiting warming to 1.5 degrees C, carbon dioxide (CO<sub>2</sub>) needs to reach net-zero between 2044 and 2052, and total GHG emissions must reach net-zero between 2063 and 2068. Reaching net zero earlier in the range avoids a risk of temporarily overshooting 1.5 degrees C. <https://www.wri.org/insights/net-zero-ghg-emissions-questions-answered>
20. BIS generally considers short-, medium-, and long-term targets to be a range of years, such as 0-5, 5-10, and 10+ years. Our goal is not to set finite timelines, but to understand how companies consider emissions reduction efforts over the years as they transition toward net zero. Consistent with guidance from [TCFD](#), specifying exact timeframes across sectors could hinder organizations’ consideration of climate-related risks and opportunities specific to their businesses. We encourage companies to decide how to define their own timeframes according to the life of their assets, the profile of the climate-related risks they face, and the sectors and geographies in which they operate.
21. “Leakage” in reference to carbon offsets generally refers to an unintended increase in greenhouse gas emissions or the shifting of emissions from one place to another. For example, leakage may occur when a carbon offset project preserved forest in one area, only to increase logging somewhere else, thus mitigating the intended purpose of removing carbon via the offset.
22. The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 Parties at COP 21 in Paris, on 12 December 2015 and entered into force on 4 November 2016.
23. See: <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>
24. Based on MSCI data. This list includes companies that were on the 2020 BIS Climate Watchlist and those that are constituents of the Climate Action 100+ focus universe, in addition to other companies that BlackRock held an equity position in on behalf of our clients as of the end of 2020.
25. Recent guidance from the International Financial Reporting Standards (IFRS) and International Auditing and Assurance Standards Board (IAASB) notes that if climate is a material risk it should be included in financial reporting considerations under existing rules. <https://www.ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf>
26. <https://www.ifrs.org/news-and-events/news/2021/11/ifrs-foundation-announces-issb-consolidation-with-cdsb-vrf-publication-of-prototypes/>
27. <https://cdn.ifrs.org/-/media/feature/news/2019/november/in-brief-climate-change-nick-anderson.pdf?la=en>
28. <https://www.iaasb.org/news-events/2020-10/iaasb-issues-staff-audit-practice-alert-climate-related-risks>
29. Based on MSCI data. Reflects companies BlackRock held an equity position in on behalf of our clients as of the end of 2020. By convention, emissions in most companies’ disclosures, and the databases that aggregate these, are reported in tons CO<sub>2</sub> equivalent (GHG emissions in tCO<sub>2</sub>e). They include carbon dioxide (CO<sub>2</sub>) but may also include methane (CH<sub>4</sub>), nitrous oxide (N<sub>2</sub>O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), Sulphur hexafluoride (SF<sub>6</sub>) and nitrogen trifluoride (NF<sub>3</sub>). All these gases contribute to climate change. Instead of reporting them separately, the convention is to convert and disclose them as a single figure.
30. The global aspiration is reflective of aggregated efforts; companies in developed and emerging markets are not equally equipped to transition their business and reduce emissions at the same rate – those in developed markets with the largest market capitalization are better positioned to adapt their business models at an accelerated pace. Government policy and regional targets may be reflective of these realities
31. <https://www.iea.org/commentaries/cop26-climate-pledges-could-help-limit-global-warming-to-1-8-c-but-implementing-them-will-be-the-key>
32. <https://www.ipcc.ch/2021/08/09/ar6-wg1-20210809-pr/>
33. Industry bodies, such as the Science Based Targets Initiative (SBTi) provide guidance and assurance processes for companies in setting GHG emissions reduction targets. SBTi provides a useful tool to help companies and investors benchmark aspirations and progress on the path to net zero.
34. <https://www.irena.org/costs>
35. [https://www.iif.com/Portals/1/Files/TSVCM\\_Summary.pdf?cldee=dmlizWthQHJlc3BvbnNpYmxlLWludmVzdG9yLmNvb0%3d%3d&recipientid=contact-38f5acba0f20e91180fe000d3a01109b-d184ec5adb7a469e82d6ec8bc7b3da4c&utm\\_source=ClickDimensions&utm\\_medium=email&utm\\_campaign=Press%20Emails&esid=f64e8b28-c160-eb11-80f0-000d3a0dce1c](https://www.iif.com/Portals/1/Files/TSVCM_Summary.pdf?cldee=dmlizWthQHJlc3BvbnNpYmxlLWludmVzdG9yLmNvb0%3d%3d&recipientid=contact-38f5acba0f20e91180fe000d3a01109b-d184ec5adb7a469e82d6ec8bc7b3da4c&utm_source=ClickDimensions&utm_medium=email&utm_campaign=Press%20Emails&esid=f64e8b28-c160-eb11-80f0-000d3a0dce1c)

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